Equity Outlook/Review

The first quarter was a strong one for equities in the US, with major indices rebounding and recouping much of the declines suffered in December. We do not believe that the severity of the declines in December were driven by fundamentals, but rather by technical factors, including quantitative trading and also tax loss selling by investors. The economy in the US remains fundamentally healthy, with low unemployment and generally robust levels of GDP growth and business activity[i]. There are areas of concern that have arisen, however, and we will be watching them for cues to increase our level of caution[ii]. These factors include a partially inverted yield curve in the US (often an early harbinger of recession), and sharp slowdowns in the economies of China and Germany[iii]. While the US economy remains relatively strong in our opinion, the Fed has taken note of slowing in other economies and has paused rate hikes for the time being. We believe that this policy is supportive of equities for the near future.

Strategy Review & Positioning

Anchor's REIT strategy generated returns of 14.8% (Gross of Fees) and 14.7% (Net of Fees) in the first quarter of 2019[iv]. These were modestly behind the 16.7% return generated by the FTSE NAREIT ALL REITs benchmark in the first quarter[v]. The largest contributors to performance in the quarter were STORE Capital Corporation (STOR), OUTFRONT Media Inc., (OUT), American Campus Communities, Inc. (ACC), Sun Communities, Inc. (SUI), and Highwoods Properties, Inc. (HIW).

Although generating positive returns in Q1, Omega Healthcare Investors, Inc. (OHI) was the largest detractor relative to benchmark performance in the first quarter, followed by Life Storage, Inc. (LSI), RLJ Lodging Trust (RLJ), Monmouth Real Estate Investment Corp. (MNR), and Iron Mountain, Inc. (IRM).

During the quarter, investments in Skilled Nursing Home REITs, Omega Healthcare and Sabra Health Care were eliminated. Continued delays to the improvement in Skilled Nursing Home fundamentals and potential risk to maintaining high dividend payouts where the primary reasons. Portions of the proceeds from these sales were used to increase investment in several existing holdings including, American Campus Communities (student housing), Outfront Media (outdoor advertising), Ryman Hospitality (resort/convention hotels) and Store Capital (single tenant real estate)[vi].

No new investments were added during the quarter in part a function of our analysis that valuations, based on multiples of cash flow are discounting higher than attainable levels of growth. Price increases in the quarter resulted in the average REIT yield declining to 3.72% (FTSE NAREIT All REITs)[vii] from 4.8% at the start of the year. Despite this decline the spread between REIT yields and ten year treasuries[viii], an often used benchmark, ended the quarter at 131 basis points above the thirty year average of 113[ix].

Anchor concludes that the economy and job growth should remain positive, albeit at a slower rate than most recent history. Under this positive macro backdrop, cash flow and dividend growth should continue to support REIT investment returns. REITs with a market capitalization of $1.1 trillion control over 20% of U.S. income producing real estate and most REITs continue to be disciplined real estate operators and allocators of capital[x]. Real Estate as the result of the 2018 inclusion in the several of the major S&P and Russell Indexes, we conclude is benefitting from increased investor demand for REITs[xi].

Anchor, a value based, research driven investment firm, continues to seek to identify REITs selling at discounts to the private market value of its real estate and or operations. Anchor REIT portfolios are characterized by lower Price to Funds from Operations (P/FFO), lower Enterprise Value to Cash Flow (EV/EBITDA less maintenance Cap Ex) and higher yields than the broad REIT industry averages[xii].

[i] U.S. Department of Commerce; https://www.usa.gov/federal-agencies/u-s-department-of-commerce

[ii] FactSet financial data and analytics; Business Description

[iii] U.S. Federal Reserve; https://www.federalreserve.gov/

[iv] FactSet financial data and analytics; Attribution Reporting

[v] https://www.reit.com/data-research

[vi] FactSet financial data and analytics; Attribution Reporting

[vii] https://www.reit.com/data-research

[viii] https://www.reit.com/data-research/reit-market-data/reitwatch-nareits-monthly-industry-data-update

[ix] https://www.reit.com/data-research/reit-market-data/reitwatch-nareits-monthly-industry-data-update

[x] https://www.reit.com/data-research/reit-market-data/reitwatch-nareits-monthly-industry-data-update

[xi] https://www.reit.com/data-research/reit-market-data/reitwatch-nareits-monthly-industry-data-update

[xii] FactSet financial data and analytics; source file reporting

For a complete listing of all strategies contact Anchor Capital Advisors LLC (617) 338-3800.